Worked example

Tax cost setting of assets – expansion of a MEC group to include new eligible tier-1 companies

Description

This example explains how the tax cost setting rules apply when a MEC group expands to include new eligible tier-1 companies (ET-1s).

→ Subdivision 719-C; Division 701; Subdivisions 705-A, 705-C and 705-D

Commentary

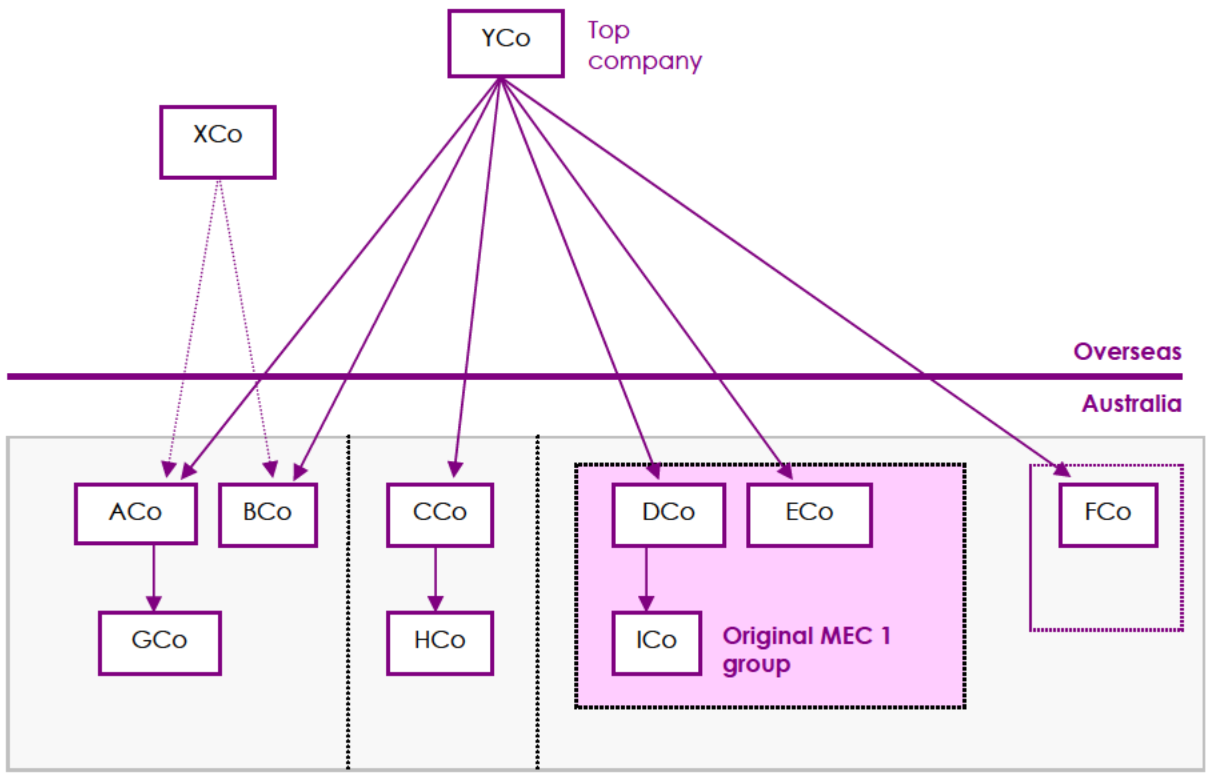
The tax cost setting rules are modified for MEC groups so that when a company joins an existing MEC group as an eligible tier-1 company it does not have the cost of its assets reset. This is also the case when all the members of a consolidated group or MEC group join another consolidated or MEC group, and the head company of the consolidated group or the eligible tier-1 companies in relation to the MEC group join at the eligible tier-1 company level.

Example

Facts

All Australian-resident entities in figure 1 below are companies that meet the eligibility requirements for consolidation.

Figure 1: MEC group expands



Initially, YCo (a foreign resident) has three wholly-owned Australian subsidiaries: DCo, ECo and ICo. DCo and ECo choose to form a MEC group (MEC 1) consisting of the three companies, with DCo as the provisional head company.

This example shows how the cost setting rules apply if YCo acquires:

- FCo (by acquiring all the membership interests in that company)
- CCo and HCo (by acquiring all the membership interests in CCo), or
- ACo, BCo and GCo (by acquiring all the membership interests in ACo and BCo, or by acquiring all the membership interests in XCo).

In each case, assume the decision is made to expand MEC 1. Note that only the provisional head company of the acquiring MEC group can choose to expand. → 'Original and new eligible tier-1 companies of a MEC group', C10-2-115

Possible outcomes

Acquisition of a single company at ET-1 level

When YCo acquires all the membership interests in FCo, FCo becomes an eligible tier-1 company. Although a non-head-company eligible tier-1 company is a subsidiary member of a MEC group (section 719-25), for the purposes of tax cost setting, such an eligible tier-1 company is treated as part of the head company. Therefore, when FCo becomes a member of the MEC 1 group, the tax costs of its assets are not reset (i.e. the assets retain their existing tax values). → Subdivision 705-A as modified by Subdivision 719-C

Acquisition of linked companies (i.e. CCo and HCo are not consolidated)

When YCo acquires all the membership interests in CCo, CCo joins the MEC 1 group as an eligible tier-1 company, and HCo joins as a subsidiary member of the group. As with the acquisition of FCo, the assets of CCo retain their existing tax values. However, the cost setting rules apply to the assets of HCo. → Subdivisions 705-D as modified by Subdivision 719-C

Acquisition of a consolidated group

If CCo and HCo had formed a consolidated group before their acquisition by YCo, the tax costs of all the assets of the acquired group are not reset (i.e. the assets retain their existing tax values). This is because CCo is treated as the only entity joining the MEC 1 group, with HCo treated as being a part of CCo. Also CCo is an eligible tier-1 company so it is treated as if it were part of DCo.

→ Subdivision 705-C as modified by Subdivision 719-C

Acquisition of a number of companies at ET-1 level (i.e. ACo, BCo and GCo are not consolidated)

When YCo acquires all the membership interests in ACo and BCo, they join the MEC 1 group as eligible tier-1 companies. Again, the assets of these companies retain their existing tax values. The assets belonging to GCo have their tax cost reset when it becomes a member of the MEC 1 group.

→ Subdivisions 705-A and 705-D as modified by Subdivision 719-C

Acquisition of a MEC group by acquiring all the eligible tier-1 companies at the same time

If ACo, BCo and GCo were members of a MEC group (MEC 2 with XCo as its top company) before the acquisition by YCo of ACo and BCo, all the assets of ACo, BCo and GCo would retain their existing tax values. This is because ACo is treated as the only entity joining the MEC 1 group, with BCo and GCo treated as parts of ACo. Also, ACo is an eligible tier-1 company so it is treated as if it were part of DCo. → Subdivision 705-C as modified by Subdivision 719-C

Acquisition of a MEC group as a whole by YCo acquiring X Co

When YCo acquires all the membership interests in XCo, ACo and BCo join the MEC 1 group as eligible tier-1 companies and their assets retain their existing tax values. As GCo was a member of the same MEC group as ACo and BCo, before the acquisition of XCo by YCo, the assets of GCo retain their existing tax values. → Subdivision 705-C as modified by Subdivision 719-C

Table 1 summarises how the tax cost setting rules apply in each case:

Table 1: Application of tax cost setting rules

Acquired entities and how acquired	Consolidation status before acquisition by YCo	Eligible tier-1 companies	Other member companies	Are tax costs of the entity's assets reset?	Relevant Subdivision
FCo	Single company	FCo		No	705-A*
CCo and HCo – by acquiring CCo	Not consolidated	CCo		No	705-D*
			HCo	Yes	
CCo and HCo – by acquiring CCo	Consolidated group	CCo		No	705-C*
			HCo	No	
ACo, BCo and GCo – by acquiring ACo and BCo	Not consolidated	ACo		No	705-D*
		BCo		No	705-A*
			GCo	Yes	
ACo, BCo and GCo – by acquiring ACo and BCo	MEC group	ACo		No	705-C*
		BCo		No	
			GCo	No	
ACo, BCo and GCo – by acquiring XCo	MEC group	ACo		No	705-C*
		BCo		No	
			GCo	No	

* as modified by Subdivision 719-C

The information in this table will also apply if:

- YCo acquires the new eligible tier-1 companies through one or more interposed foreign-resident entities, or entities that are ineligible to be members of the MEC group (for example, a prescribed dual resident), or
- YCo acquires the new ET-1 companies, jointly with any of the above interposed entities, or

- YCo acquires the new ET-1 companies jointly with a member of the MEC group.

Acquisition at other than ET-1 level

When an entity is acquired at a level other than the eligible tier-1 company level, the costs of its assets are reset under the relevant subdivision of Division 705 as modified by Subdivision 719-C.

References

Income Tax Assessment Act 1997, Division 705; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 5

Income Tax Assessment Act 1997, Division 705; as amended by *New Business Tax System (Consolidation, Value Shifting, Demerger and Other Measures) Act 2002* (No. 95 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, Chapter 1

Income Tax Assessment Act 1997, Division 705 and Subdivision 719-C; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedules 4 and 8

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, Chapters 1 and 3

Income Tax Assessment Act 1997, Subdivision 719-C; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003)*, Schedules 11 and 12

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 2

Revision history

Section C10-2-215 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
26.10.05	Extensive changes throughout.	For clarification.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).